

PROFESSIONAL RISK MANAGEMENT BULLETIN

Technical Bulletin
Managing the professional liability of accountants (N1)
(Issued July 1999)

Appendix II - Corporate Practice

1. Amendments to the Professional Accountants Ordinance Cap 50 and the Companies Ordinance were made in 1995 and were brought into effect in August 1996 to allow incorporation of CPA practices. Prior to this legislative reform, CPAs could only practise in the form of sole proprietorships or partnerships.
2. Where CPAs practise in partnership, each of the partners has full, unlimited and joint and several personal liability for the debts of the partnership, including liability for damages arising out of a professional negligence claim. Each partner, therefore, has unlimited personal liability for all damages awarded against the firm in a negligence claim, regardless of whether or not, or the degree to which, that partner was at fault or even involved in the particular engagement which gave rise to the liability.
3. The position is different with a corporate practice. The corporate practice is a legal entity distinct from its director shareholders. It is a requirement of the Corporate Practices (Registration) Rules that each shareholder of the Corporate Practice be also a director and vice-versa. The corporate practice conducts business as principal. Its director shareholders are agents of the corporate practice, not of each other. A contractual relationship will exist between the corporate practice itself and its clients such that the corporate practice will be liable in contract, and in tort, to any client who suffers loss as a result of negligence in the conduct of an engagement.
4. Director shareholders of a corporate practice, unlike partners in a partnership, do not have personal liability for the debts of the corporate practice. Nor are they personally liable for the negligence of any other director shareholder of the practice. Therefore, as a general rule, individual director shareholders will not have any personal liability for damages assessed against the corporate practice as a result of a negligence claim.
5. However, individual director shareholders of a corporate practice who are involved in an engagement will also owe a duty of care in tort to the client in respect of that engagement. If the director shareholder is negligent, he may be personally liable to pay damages to that client if the client suffers loss as a result of that negligence. In addition, the corporate practice will normally be liable. The director shareholder may also have a liability to third parties to whom a duty of care is owed.
6. In the context of a statutory audit, each director shareholder who is involved in the audit engagement will owe a duty of care to the client and will have potential personal liability for his own negligence. This will apply for example in the case of:-
 - (a) the responsible director shareholder, even if he himself does not sign the audit report;
 - (b) any other director shareholder involved in carrying out part of the audit engagement, even if he does not sign the audit report;
 - (c) conceivably, in certain circumstances, any other director shareholder who signs the audit report, even if that director did not carry out or supervise any part of the audit engagement.Director shareholders should therefore take the steps recommended in paragraph No. 10 below.
7. It is also conceivable that, in certain circumstances, an "authorised person", who signs an audit report pursuant to Rule 24 of the Corporate Practices (Registration) Rules may incur personal liability to a client or to a third party who relies on that report.
8. Thus, a director shareholder and an authorised person may have personal liability for their own negligence. They should not, as a general rule, have any personal liability for the negligence of other director shareholders. However, much will depend on the circumstances and the manner in which the law relating to corporate practice develops.
9. Similar considerations to the above will apply not only to audit but to all other engagements.
10. Therefore, to limit potential exposure, those involved in corporate practices should try to ensure:-
 - (i) that any director shareholder or authorised person signing off on an engagement, particularly where the engagement has been carried out wholly or partly by another director shareholder or employee of a corporate practice, is satisfied that the engagement has been completed with reasonable skill and care before signing off;
 - (ii) that if any limitations or disclaimers of liability are agreed between the client and the corporate practice (as to which see paragraphs Nos. 49-52 of the Bulletin and paragraph No. 11 of Appendix I) they extend where possible to all directors shareholders and employees of the corporate practice. The effectiveness of any such limitations or disclaimers will, as previously, be subject to the provisions of the Control of Exemption Clauses Ordinance and the Unconscionable Contract Ordinance and Section 165 of the Companies Ordinance. Reference is made to Appendix I.

N1: This statement is based on similar guidance issued by The Institute of Chartered Accountants in England and Wales (ICAEW) appropriately adapted to the local context. The Society gratefully acknowledges the permission given by the ICAEW in this respect.